STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

AGL Resources Nicor Inc., and	**)**	
Northern Illinois Gas Company	**)**	
d/b/a Nicor Gas Company	**)**	
	)	**Docket No. 11-0046**
Application for Approval of a Reorganization	**)**	
Pursuant to Section 7-204 of the Illinois	**)**	
Public Utilities Act	**)**	

BRIEF ON EXCEPTIONS AND EXCEPTIONS OF THE PEOPLE OF THE STATE OF ILLINOIS AND THE CITIZENS UTILITY BOARD

October 13, 2011

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NOW COME the People of the State of Illinois ("the People"), by Lisa Madigan, Attorney General of the State of Illinois, and the Citizens Utility Board, through its attorney, pursuant to Part 200.830 of the Illinois Commerce Commission's ("the Commission") rules, 83 Ill.Admin.Code Part 200.830, and in accordance with the schedule established in this docket, hereby file their Brief on Exceptions and Exceptions to the Proposed Order ("PO") issued by the Administrative Law Judge in the above-captioned docket on September 29, 2011.

I. INTRODUCTION

The AG and CUB appreciate and commend the Proposed Order ("PO") for providing a carefully considered, balanced and well-reasoned analysis of the issues regarding the affiliate Operating Agreement issues addressed in this docket. The PO demonstrates a clear understanding of the relevant legal standards and largely frames the issues and applies the facts in a fair and studied manner. The PO's analysis is particularly on point in its discussion of Nicor Gas's involvement in the provision and solicitation of Gas Line Comfort Guard ("GLCG") on behalf of its affiliate, Nicor Services, and correctly concludes that 1) NG's provision of

solicitation services on behalf of NS for GLCG provides an unlawful subsidy to the affiliate; 2) NS's solicitation privileges during inbound customer calls to NG have substantial anti-competitive impact in NG's service territory, which is adverse to the public interest; and 3) the GLCG solicitations performed during consumer calls to the utility are misleading and not in the public interest for NG to continue facilitating such solicitation. ALJPO at 54, 63, 67. Using the same rationale, the Commission should extend this well-supported conclusion to prohibit the use of Nicor Gas resources, including its billing envelopes, for any printed GLCG solicitations.

While AG-CUB agree with many of the Proposed Order's conclusions, AG-CUB disagree that the evidence in the proceeding allows the Commission to make the required findings for approval of the proposed reorganization of Nicor, Inc and AGL Resources Inc. AG-CUB continue to have concerns about the evidentiary basis for the Commission to make findings necessary for approval of the merger under Section 7-204(b)(1) and (c) of the Act . Namely, AG-CUB believe the PO's conclusion regarding the allocation of savings fails to provide ratepayers with assurance that the Joint Applicants ("JA") will, in fact, capture and track savings resulting from the merger, despite the PO's intention to ensure that all regulated utility savings are passed on to Nicor Gas ratepayers. By failing to address the JA's insistence that no savings to the regulated utility will result from the merger despite its admission that a savings analysis has not been performed and that no savings are currently "identifiable or quantifiable", the PO leaves open the possibility that Nicor Gas could experience significant savings, and earn more than its authorized return by enjoying the benefit of reduced operating costs, while simultaneously denying rate payers the benefit of these efficiencies. If the reorganization is approved, over the objections of AG-CUB and Staff, the Commission must be able to track the post-merger savings – particularly any savings allocated to Nicor Gas from its affiliates.

Additionally, the evidence does not support a finding that the proposed reorganization will not diminish Nicor Gas' ability to provide adequate, reliable, efficient and least cost public utility service, pursuant to Section 7-204(b)(1) of the Act, as discussed further below. AG-CUB urges the Commission to modify the ALJPO in accordance with the arguments presented in this Brief.

II. EXCEPTIONS

A. Exception No. 1 -- The Commission Lacks the Evidence to Conclude that the Proposed Reorganization Will Not Diminish Nicor Gas' Ability to Provide Adequate, Reliable, Efficient and Least Cost Public Utility Service, Pursuant to Section 7-204(b)(1) of the Act.

The Proposed Order has concluded that "…there is sufficient record evidence to support the finding required by subsection 7-204(b)(1) that the merger will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service." ALJPO at 15. The Proposed Order arrives at this conclusion on the basis of 1) AGL's "track record" in the natural gas industry; 2) AGL's oft-stated commitment to maintain the utility's aggregate staffing level for three years after the merger; and 3) the integration process which the JA have pursued to implement the convergence of AGL and Nicor Gas.

The People take exception with the Proposed Order's reliance on these factors for a variety reasons. Chief among these is the Order's view of the integration process as a harbinger of the JA commitment to service quality. The Proposed Order alleges that criticisms lodged by AG/CUB and Staff witness Maple that the integration planning process is still incomplete are less compelling than the fact that the integration process is ongoing and that no party has challenged that fact. ALJPO at 13. But it is not the fact that the integration process is continuing that is the basis for AG/CUB's objections to the proposed reorganization. The Proposed Order is wrong when it alleges that the AG and CUB are insisting that integration

activities "…must be *completed* before the Commission can reasonably render the finding required by subsection 7-204(b)(1)." PO at 13, emphasis in original. Rather, the main reason for AG/CUB's questioning of the JA's integration process was that for all its alleged importance, the process had produced almost no information that the Commission could rely upon in its Section 7-204 analysis. For example, in opposing the proposed reorganization, Staff witness Maple notes that AGL did not perform the comprehensive due diligence one would expect from an acquiring company, involving examination of financial records, personnel, legal and regulatory issues, physical assets and operational procedures and costs. AG/CUB Corr. In. Br. at 7, citing Staff Ex. 11.0R at 4. Maple further testified that he has "seen no substantive evidence that AGL has a fundamental knowledge of the Nicor Gas operational system." Staff Ex. 17.0 at 3. The evidence suggests that while the two merging corporations may feel comfortable with their plans for corporate merger and reorganization, the record lacks evidence as to what the Commission and Nicor Gas ratepayers can expect related to the AGL/Nicor Inc./Nicor Gas reorganization, particularly as it relates to the statutory standard that the reorganization not diminish the utility's ability to provide adequate, reliable, efficient, safe and least cost public utility service. 220 ILCS 5/70204(b)(1).

It is uncontroverted in this record that despite numerous attempts during discovery by Staff, AG and CUB to ascertain exactly what effect the merger will have on public utility service for Nicor Gas customers – which is, in fact, the finding the Commission is required to make in approving mergers under the Public Utilities Act – the Staff and parties received little from the JA besides assurances that they were "engaged in the integration planning process." AG/CUB Corr. In. Br. at 9, citing Staff Ex. 11.0 at 11-12. The fact that the JA integration process is ongoing and designed to uncover "best practices," or that it involves "a significant commitment

of personnel," as noted by the Proposed Order, has nothing to do with meeting the statutory standard set forth in section 7-204(b)(1): before it can approve a merger, the Commission must make a finding that the proposed merger not threaten the quality of service to be provided to ratepayers by the utility following the merger. Whether or not the integration process is completed is much less relevant than what the integration process can tell the Commission about the impact of the reorganization on the ability of the utility to provide the requisite quality of service. The value of the integration process notwithstanding, the AGL/Nicor application has not provided sufficient information for the Commission to make this finding and the reasoning supplied in the Proposed Order does not change this fact.

As for the other reasons cited in the Proposed Order to support the required 7-204(b)(1) finding -- AGL's industry "track record" and its commitment to maintain staffing levels – both have very little actual evidentiary basis. For example, the Proposed Order's description of AGL's track record in the natural gas distribution utility industry consists of a one-sentence summary of the JAs very paltry presentation on this issue: "In this instance, JA have shown that AGL has acquired natural gas distribution utilities on three previous occasions and (as catalogued above) now controls six such companies with 2.3 million customers in six states." ALJPO at 12. AGL's "track record" evidence on utility acquisition was so general that it revealed nothing specific about the history of those mergers or their impact on utility ratepayers, which, of course, is the purpose of the 7-204(b)(1) finding. The AGL personnel commitment is similarly unreliable. It was described in the AG/CUB Initial Brief at pages 22 through 28, and exposed through cross-examination as "…a sophisticated shell game whereby the JAs make it appear staffing will remain stagnant when it is quite possible that staffing reductions will occur." AG/CUB Corr. In. Br. at 25.

Finally, the late-filed evidence submitted to the Commission by IBEW Locals on October 11 may cast a new light on these two issues and the Proposed Order's reliance on the JA's representations if admitted into the record. Specifically, in their "Verified Motion for Admission of Late-Filed Exhibits and to Re-Open the Record" ("Motion"), the IBEW Locals asserts that there may be reason to question the credibility of AGL's representations regarding its acquisition history and its promise to maintain current staffing levels at Nicor Gas. The Motion and attached testimony describes AGL's track record following acquisitions of gas utilities in other states and presents new facts regarding AGL's commitment to the IBEW on the staffing issue.

Evidence on both of these topics is relevant to the Commission's consideration of the JA's ability to demonstrate compliance with Section 7-204(b)(1). The evidence presented with the Motion on previous AGL mergers, if admitted, could fill in some of the evidentiary gaps that may not have been properly addressed in the existing record. If the Proposed Order describes the aforementioned minimal evidence as "…unquestionably probative of an ability on the part of AGL to manage NG without diminish [sic] the utility's quality of service," ALJPO at 12, certainly an examination of much more specific and detailed information on this exact topic may assist the Commission in its inquiry.

More important, the Motion provides a factual explanation for the absence in the record of union-sponsored evidence on one of the critical issues in this case, AGL's commitment to maintain current staffing levels at Nicor Gas for three years. The ALJPO pointed to this lack of evidence in rejecting the unions' proposed merger conditions. The Motion, however, explains how, as this case proceeded since the JA's January 2011 filing, the unions reasonably relied on AGL's pledge to maintain staffing levels – a promise which the Proposed Order repeatedly cites in support of Commission approval of the merger – and how AGL's most recent dealings with

the union during the past two months present a different perspective on the personnel issue. The Proposed Order's reliance on this commitment is unreserved, as it goes so far as to assert that "[A]fter merger, staffing levels will be maintained, generally by the same people in place now." ALJPO at 13. Without evaluating that evidence here, AG and CUB believe that the Proposed Order's description of the JA's personnel commitments as "empirically sound in their own right and indicative of an intention to maintain future utility service quality," ALJPO at 12, must at least be revisited.

Proposed Exceptions Language

The People and CUB recommend that the language on page 15 of the Proposed Order regarding the proposed reorganization's compliance with Section 7-204(b)(1) be modified as follows:

Commission Conclusion

The Commission concludes that there is insufficient record evidence to support the finding required by subsection 7-204(b)(1) that the merger will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service. There is little record ~~E~~evidence of AGL's and Nicor's prior and ongoing experience in the operation of natural gas distribution utilities ~~and~~ or of AGL's experience with previous mergers of such utilities., ~~of the JA's binding operational and financial commitments (as described in this Order and included in Merger conditions), and of the o~~ Ongoing activities to integrate the utility with the acquiring entity, have revealed little information to enable to Commission to evaluate the proposed reorganization's impact on the post-merger utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service, as required by 7-204(b)(1). ~~collectively satisfies the statute. No contradictory inferences are supported by the record.~~ Without such information, the Commission is unable to make the finding required by law that enables it to

approve the merger, the record being unsatisfactory in this regard and the Joint Applicants having failed to meet their burden of proof.

~~With respect to NG's workforce, the Commission approves the JA's commitments to honor NG's existing CBAs and to maintain its current Illinois staffing levels for three years (and, in some cases, give years) after completion of the Reorganization, as these commitments are described in section II.C of this Order. Lacking any supporting evidence, the IBEW's request for a continuation of the staffing levels in each classification in the Local 19, IBEW CBA will not be explicitly included in a merger condition. However, if the terms of the Local 19 CBA would require continued per-classification staffing, then the JA, through their promise to fully honor existing CBAs, will retain that obligation. Job retention for individual employees will also not be included as a merger condition here, again for complete lack of evidence supporting it.~~

B. Exception No. 2 – The Record Evidence Does Not Support a Finding that Ratepayers Will See the Benefit of any Merger-Related Savings Under the Staff/JA Stipulation, and that, Accordingly, Section 7-204(c) Has Been Satisfied.

Section 7-204(c) provides that the Commission "shall not approve a reorganization without ruling on: (i) the allocation of any savings resulting form the proposed reorganization; and (ii) whether the companies should be allowed to recover any costs incurred in accomplishing the proposed reorganization and, if so, the amount of costs eligible for recovery and how the costs will be allocated." 220 ILCS 5/7-204(c). In analyzing this statutory requirement, the Proposed Order focuses on the stipulation entered into between the Joint Applicants and Staff, which provides for the following:

- JA and Staff agree that achieved savings at NG resulting from the proposed Reorganization, if any, shall be flowed through to NG customers as part of costs associated with the regulated intrastate operations for consideration in a future rate case filed by NG."

- NG's rates will be fixed at their current rates for a period of three years following the close of the merger "[i]n order to provide rate certainty for customers for a period following the Reorganization, and to allow the effect of savings, if any, to materialize".

- JAs retain the right to request that the Commission waive the timing provision set forth above "if the financial integrity of NG is jeopardized to the extent of negatively affecting customers." *Id.* Under the terms of this provision, customers will receive all of the achieved savings, if any, associated with the test year in that case as an embedded reduction to the cost of service from that period forward, according to the stipulation.[1]

ALJPO at 31-32.

In assessing the stipulation, the PO then concludes:

> The issue, then, is whether the Stipulation, if approved by the Commission would be sufficient to support the findings required by the two sub-parts of subsection 7-204(c). The resolution of that issue is found within the interplay between the pertinent statutory text and the first numbered paragraph above. Subpart (i) of the statute contemplates an "allocation of any savings." Both before and after the Stipulation was filed, the argument between the JA and AG/CUB focused on the implications of the word "any" (that is, whether there will be savings, when they will occur, their quantification, and the degree to which they will arise from regulated business). In our view, the Stipulation moves the necessary analysis to the word "allocation," which we construe as a directive to determine the *beneficiaries* of savings and to *apportion* their respective shares. Under the first indented paragraph above, the *only* beneficiaries are NG's ratepayers. Thus, whether savings result or not, and whatever their magnitude, they must all flow to ratepayers to reduce NG's purported recoverable costs in a ratemaking proceeding. In statutory terms, that is the requisite allocation of any and all savings generated by the proposed Reorganization.

ALJPO at 33. Here, the Proposed Order reasons, essentially, that under Section 7-204(c), the Commission need not delve into the issue of whether savings will, in fact, occur when addressing

[1] Under the stipulation, JA and Staff agree, subject to the terms set forth in Section 7-204(c)(i) above, that the costs incurred in accomplishing the proposed Reorganization shall not be recovered through Illinois jurisdictional regulated rates in this or any future proceeding. The costs at issue (*i.e.*, Transaction Costs, Change in Control Costs, Financing Costs, Separation Costs, and Legal and Other Professional Costs) included in the JAs' Supplemental Response to Staff Data Request RWB 3.01, Exhibit 5 (Staff Group Cross Exhibit 2 (Public) at 7-8 (NRE 004555-4556)), are the costs incurred in accomplishing the proposed Reorganization, which will not be recovered through Illinois jurisdictional rates.

how any savings will be allocated. While the Proposed Order argues that the "allocation" is only at issue, due to the fact that all savings, if any, would be allocated to ratepayers in a future NG rate case, it fails to describe how any savings would be tracked, especially in light of the new AGL services company arrangement that presumably impacts how costs and any merger savings would be allocated among the affiliates. The promise of receiving "all savings, if any" at some point in the future through embedded cost of service numbers is an empty promise if there is no specific mechanism or system in place to track any merger savings. Likewise, the promise is a hollow one if the order accepts, or fails to comment on, the JAs' insistence that there will, in fact, be no merger savings for Nicor Gas customers.

As documented in the AG-CUB Initial and Reply briefs, the JA have consistently refused to provide any analysis regarding post-reorganization savings and persist in their claim that no "immediate" savings will result from the Reorganization. AG-CUB Init. Br. at 23-28; AG-CUB Reply Br. at 9-16. The JA claim such an analysis has not been performed and that no savings are currently "identifiable or quantifiable." JA Ex. 11.0 at 6; JA Init. Br. at 28. On the other hand, AG-CUB witness David Effron testified that the JA's claims that no savings should be expected (because only non-regulated business cost of service would benefit from the merger) is not discussed or evaluated. The AG-CUB brief detailed inconsistency after inconsistency in the evidence supplied by the JAs on the subject of potential savings. These inconsistencies are not addressed in the Proposed Order.

For example, on the one hand, JA claim that the proposed reorganization will create efficiencies, noting that "(s)cale can provide many of the efficiencies and resources needed in the changing (natural gas utility) landscape." JA Ex. 1.0 at 6. On the other hand, the JAs insist that any merger savings that are likely to occur as a result of the reorganization will happen at the

corporate parent level, i.e. the unregulated side of the business. Tr. at 462-463. In other words, synergies might inure between AGLR and Nicor, Inc., but Nicor Gas and its ratepayers will not specifically experience cost savings. Tr. at 461. This claim, they argue, is reliable principally because 1) of their commitment to maintain the number of gas distribution "full-time equivalent employees" at a level comparable to current numbers, and 2) because Nicor Gas "is far and away the lowest-cost provider (of natural gas delivery service) in the state of Illinois. Tr. at 461.

Notwithstanding their insistence throughout this case that the merger will only produce savings for the two corporate parent companies, AGL and Nicor, Inc. ("NI"), and that there are no identifiable savings or even estimates to be quantified for the regulated utility, the JA also state that "To date, no analyses have been performed to determine any areas where synergies or savings may be potentially achieved as a result of the reorganization."[2] This intransigence on the issue of identifying savings and costs comes despite the fact that the JA testified that an integration planning process has been ongoing since January of 2011. Tr. at 383. The claim that no savings will accrue to the regulated utility simply is not credible in light of the following facts:

- In nearly every merger/reorganization petition presented to the Commission since Section 7-204(c) became law, the merger petitioners specifically identified anticipated savings at both the corporate parent level and the regulated utility level in their petitions and/or pre-filed testimony. For example, the WPS Resources Corporation/Peoples Energy Corporation/The Peoples Gas Light & Coke Company/North Shore Gas Company petition, provided *at the start of the docket* that the petitioners estimated that annual savings in personnel costs of $33.8 million could be expected, with 79% of that savings coming from reductions to corporate staffing.[3]

- Assuming savings are achieved at the corporate level only, the parent company costs that are allocated to the regulated utility, Nicor Gas, in every rate case, stand to be reduced if the JA claims about corporate efficiencies are to be believed.[4]

[2] AG Cross Ex. 7 (JA Response to AG 1.19).
[3] AG Ex. 3.0 at 5.
[4] *See* AG Cross Ex. 5, Tr. at 383-398.

- Despite their alleged inability to identify synergies or savings, the JA *have* identified expected separation costs of $21 million, plus additional separation costs associated with the highest ranking Nicor Inc executives. Such separation costs would be incurred in conjunction with a reduction to the number of administrative, management, and executive employees enabled by the merger. As noted by AG/CUB witness David Effron, "there would be no purpose to such separation costs, unless the anticipated savings from the employee separations were significantly greater than the costs."[5]

- While the JA claim that the merger "is really based on long term best practices and scale and scope that can keep costs, over the long term low for our customers,"[6] the JA witnesses were unable to come up with a consistent definition of "long term," thereby creating doubt about their claims that near term synergies or savings are not identifiable in the short run, long run or otherwise.

- The JA stand to gain additional efficiencies through their commitment to maintain the number of gas distribution "full time equivalent employees" ("FTEs") at a level comparable to the current level.[7] Moreover, this commitment does not apply to Nicor Gas administrative employees and Nicor, Inc. employees, a portion of whose salaries are allocated to Nicor Gas.

- Savings can be achieved as a result of the merger in areas other than staffing, such as facilities integration, professional services, purchasing and information technology.[8]

- The Commission Staff believes the JAs failed to provide sufficient information to determine what effect the proposed reorganization would have on Nicor Gas's ability to provide adequate, reliable, efficient, safe and least-cost public utility service.[9]

- Staff also testified that the applicants failed to conduct a thorough due diligence review, and as such the merger should be denied.

The JA assertion that they have not identified any savings for the regulated utility and that savings will only occur at the corporate level over the long run rings hollow when the JAs also admit that they performed no analyses to determine any areas where synergies or savings may be potentially achieved as a result of the reorganization. Because the JA's have failed to quantify any level of savings at all, this does not constitute sufficient evidence for the Commission to render a ruling on

[5] AG/CUB Ex. 3.0 at 5.
[6] JA Ex. 11.0 at 7.
[7] Tr. at 461, *Id.* at 576.
[8] *Id.* at 4.
[9] Staff Ex. 11.0 at 3.

"(i) the allocation of any savings resulting form the proposed reorganization; and (ii) whether the companies should be allowed to recover any costs incurred in accomplishing the proposed reorganization and, if so, the amount of costs eligible for recovery and how the costs will be allocated." 220 ILCS 5/7-204(c).

AG/CUB witness David Effron testified that he believed the merger would result in immediate savings that can and should be quantified. For example, the JAs provided an estimate of merger related costs in their information responsive to the requirements of 220 ILCS 5/7-204(a)(3). One of the items is "Separation Costs" of $21.0 million (Update as of April 22, 2011). Such separation costs would be incurred in conjunction with a reduction to the number of administrative, management, and executive employees enabled by the merger. In response to AG Data Request 2.03, the Applicants had stated that they had not quantified the annual reduction to personnel cost that could be achieved as a result of such employee separations. However, there would be no purpose to such separation costs, unless the anticipated savings from the employee separations were significantly greater than the costs. AG/CUB Ex. 4.0 at 6.

In addition, less than half of the forecasted savings in Docket No. 06-0540 were estimated to come from staffing reductions ($170.5 million out of total savings of $373.0 million in the first five years following the merger). Therefore, Mr. Effron rejected the notion that the commitment to maintain the number of Nicor Gas distribution FTEs at the current level means that there will be no synergies or cost savings opportunities in the period immediately following the merger. In fact, he stated that given the anticipated separation of administrative and management employees and the Applicants statements in their presentation materials regarding "achievable financial and operational benefits driven by increased scale and scope" and "savings through the elimination of duplicate public company costs," he believes that it is highly likely

that completion of the merger will produce immediate savings from synergies and economies of scale. AG/CUB Ex. 3.0 at 6.

As argued in AG-CUB's Initial and Reply briefs, the JA's FTE commitment does not in itself demonstrate that no savings could be achieved immediately post-reorganization, because it allows for staffing reductions and other efficiencies to be gained, which could result in savings attributable to the utility. AG-CUB Init. Br. at 22-28, AG-CUB Reply Br. at 11-12. JA witness Reese agreed that the FTE commitment cannot be construed as committing to a particular employee count: that is, it does not mean that no Nicor Gas employees will be terminated or that headcount will not decrease. Tr. at 545:2-6. Mr. O'Connor also acknowledged that the FTE commitment would allow the JAs to use existing resources at AGL to subsume utility-related tasks. Tr. at 419-20. Therefore, AGS resources could replace existing utility staff while maintaining the FTE commitment. Additionally, the integration process has not yet been completed and the JAs are actively evaluating staffing decisions. See AG Cross Ex. 6 (JA DRR to AG 1.04). This process will ultimately lead to possible staffing reductions. Because the FTE commitment will allow the post-Reorganization utility to reduce its operating costs by reallocating resources and utilizing AGL Services to perform work, immediate savings are likely to be achieved. Furthermore, Mr. Lingenfelter testified that the post-Reorganization company may potentially move certain services currently provided by Nicor Gas personnel to the AGL Services Company, which is the arrangement currently used by AGL for its call service centers.[10] Tr. at 569.

[10] Although not in the record as of this writing, in a Motion for Admission of Late-Filed Exhibits and To Reopen the Record filed by Local Unions No. 19, 117, 134, 150, 176, 364, 461 and 701, International Brotherhood of Electrical Workers, AFL-CIO ("IBEW Locals"), ("Motion"), and its attached verified testimony, IBEW reveals its concerns through its expert Mark Klinefelter with the JA's FTE commitments and the possibility that AGL could move call center work out of the state or country and replace those Illinois union jobs with AGL corporate jobs. See Motion and attached U-05 Ex. 1.0 at 6-7.

Thus, while the evidence makes clear that savings are likely to be achieved in the near term, the PO fails to present an analysis of this evidence of immediate potential savings in its analysis of 7-204(c).

When the evidence is viewed as a whole, it is clear that there is a certain, troubling nonchalance in the Companies' attitude toward calculating savings that is inconsistent with the Commission's duty under Section 7-204(c) of the Act. The Commission is charged with allocating any savings resulting from the proposed reorganization, and cannot approve a reorganization without ruling on the savings issue. 220 ILCS 5/7-204(c). Moreover, when asked to provide an estimate of the long-term operational benefits that will inure to the benefit of Nicor Gas customers, *the JA's position is that review has not been performed.* Tr. at 595; AG Cross Ex. 19 (JA Response to AG 1.07). Mr. O'Connor, however, testified that "the Joint Applicants have evaluated and determined that there are not quantifiable savings related to Nicor Gas resulting from the proposed reorganization." JA Ex. 11.0 at 6. As Mr. Effron rightly notes, "It appears to be the Joint Applicants' position that because they have not presented any estimate of the savings from the reorganization, there will be no savings. This is a non-sequitur, and any claim of zero savings is not plausible." AG/CUB Ex. 4.0 at 7.

In sum, a stipulation that allocates any savings that might be achieved as a result of the merger to ratepayers in no way protects or benefits ratepayers if the JA have predetermined that there are no savings to be had. The JA have made clear that they do not expect, and indeed may not be looking for, merger savings at the regulated utility level. The evidence suggests otherwise, yet no tracking mechanism exists to monitor whether savings are, in fact, occurring. Accordingly, the stipulation's promise to allocate all savings to ratepayers in a future rate case is a hollow promise that in no way satisfies the statutory requirement of Section 7-204(c) of the

Act. Should the Commission nevertheless determine that Section 7-204(c) has been satisfied, at a minimum, it should add as a condition of merger approval a requirement that the JA specifically track and demonstrate how any savings have been allocated through the new AGL service company to its affiliates, including Nicor Gas, and does not present JA with an opportunity to diminish any merger-related savings that would otherwise to ratepayers.

Proposed Exceptions Language:

In accordance with the arguments presented above, the following modifications to the PO should be made:

There are two inherent problems with the Staff/JA stipulation, however. While the stipulation provides that all savings, if any, would be allocated to ratepayers in a future NG rate case, it fails to describe how any savings would be tracked. The promise of receiving "all savings, if any" at some point in the future through embedded cost of service numbers is a meaningless promise if there is no specific mechanism or system in place to track any merger savings. Likewise, the promise is a hollow one if we accept, or fail to comment on, the JAs' insistence that there will, in fact, be no merger savings for Nicor Gas customers.

As documented in the AG-CUB Initial and Reply briefs, the JA have consistently refused to provide any analysis regarding post-reorganization savings and persist in their claim that no "immediate" savings will result from the Reorganization. AG-CUB Init. Br. at 23-28; AG-CUB Reply Br. at 9-16. The JA claim such an analysis has not been performed and that no savings are currently "identifiable or quantifiable." JA Ex. 11.0 at 6; JA Init. Br. at 28. On the other hand, AG-CUB witness David Effron testified that the JAs claims that no savings should be expected (because only non-regulated business cost of service would benefit from the merger) is not discussed or evaluated. The AG-CUB brief detailed inconsistency after inconsistency in the evidence supplied by the JAs on the subject of potential savings. These inconsistencies are not addressed in the Proposed Order.

For example, on the one hand, JA claim that the proposed reorganization will create efficiencies, noting that "(s)cale can provide many of the efficiencies and resources needed in the changing (natural gas utility) landscape." JA Ex. 1.0 at 6. On the other hand, the JAs insist that any merger savings that are likely to occur as a result of the reorganization will happen at the corporate parent level, i.e. the unregulated side of the business. Tr. at 462-463. In other words, synergies might inure between AGLR and Nicor, Inc., but Nicor Gas and its ratepayers will not specifically experience cost savings. Tr. at 461. This claim, they argue, is reliable principally because 1) of their commitment to maintain the number of gas distribution "full-time equivalent employees" at a level comparable to current numbers, and 2) because Nicor Gas "is far and away

the lowest-cost provider (of natural gas delivery service) in the state of Illinois. Tr. at 461.

Notwithstanding their insistence throughout this case that the merger will only produce savings for the two corporate parent companies, AGL Resources Inc. ("AGL") and Nicor, Inc. ("NI"), and that there are no identifiable savings or even estimates to be quantified for the regulated utility, the JA also state that "To date, no analyses have been performed to determine any areas where synergies or savings may be potentially achieved as a result of the reorganization."[11] This intransigence on the issue of identifying savings and costs comes despite the fact that the JAs testified that an integration planning process has been ongoing since January of 2011. Tr. at 383. The claim that no savings will inure to NG simply is not credible in light of the following facts:

- In nearly every merger/reorganization petition presented to the Commission since Section 7-204(c) became law, the merger petitioners specifically identified anticipated savings at both the corporate parent level and the regulated utility level in their petitions and/or pre-filed testimony. For example, the WPS Resources Corporation/Peoples Energy Corporation/The Peoples Gas Light & Coke Company/North Shore Gas Company petition, provided *at the start of the docket* that the petitioners estimated that annual savings in personnel costs of $33.8 million could be expected, with 79% of that savings coming from reductions to corporate staffing.[12]

- Assuming savings are achieved at the corporate level only, the parent company costs that are allocated to the regulated utility, Nicor Gas, in every rate case, stand to be reduced if the JAs claims about corporate efficiencies are to be believed.[13]

- Despite their alleged inability to identify synergies or savings, the JAs *have* identified expected separation costs of $21 million, plus additional separation costs associated with the highest ranking Nicor Inc executives. Such separation costs would be incurred in conjunction with a reduction to the number of administrative, management, and executive employees enabled by the merger. As noted by AG/CUB witness David Effron, "there would be no purpose to such separation costs, unless the anticipated savings from the employee separations were significantly greater than the costs."[14]

- While the JAs claim that the merger "is really based on long term best practices and scale and scope that can keep costs, over the long term low for

[11] AG Cross Ex. 7 (JA Response to AG 1.19).
[12] AG Ex. 3.0 at 5.
[13] *See* AG Cross Ex. 5, Tr. at 383-398.
[14] AG/CUB Ex. 3.0 at 5.

our customers,"[15] the JA witnesses were unable to come up with a consistent definition of "long term," thereby creating doubt about their claims that near term synergies or savings are not identifiable in the short run, long run or otherwise.

- The JAs stand to gain additional efficiencies through their commitment to maintain the number of gas distribution "full time equivalent employees" at a level comparable to the current level.[16] Moreover, this commitment does not apply to Nicor Gas administrative employees and Nicor, Inc. employees, a portion of whose salaries are allocated to Nicor Gas.

- Savings can be achieved as a result of the merger in areas other than staffing, such as facilities integration, professional services, purchasing and information technology.[17]

- The Commission Staff believes the JAs failed to provide sufficient information to determine what effect the proposed reorganization would have on Nicor Gas's ability to provide adequate, reliable, efficient, safe and least-cost public utility service.[18]

- Staff also testified that the applicants failed to conduct a thorough due diligence review, and as such the merger should be denied.

The JA assertion that they have not identified any savings for the regulated utility and that savings will only occur at the corporate level over the long run rings hollow when the JAs also admit that they performed no analyses to determine any areas where synergies or savings may be potentially achieved as a result of the reorganization. This does not constitute sufficient evidence for the Commission to render a ruling on "(i) the allocation of any savings resulting form the proposed reorganization; and (ii) whether the companies should be allowed to recover any costs incurred in accomplishing the proposed reorganization and, if so, the amount of costs eligible for recovery and how the costs will be allocated." 220 ILCS 5/7-204(c).

AG/CUB witness David Effron testified that he believed the merger would result in immediate savings that can and should be quantified. For example, the JAs provided an estimate of merger related costs in their information responsive to the requirements of 220 ILCS 5/7-204(a)(3). One of the items is "Separation Costs" of $21.0 million (Update as of April 22, 2011). Such separation costs would be incurred in conjunction

[15] JA Ex. 11.0 at 7.
[16] Tr. at 461, *Id.* at 576.
[17] *Id.* at 4.
[18] Staff Ex. 11.0 at 3.

with a reduction to the number of administrative, management, and executive employees enabled by the merger. In response to AG Data Request 2.03, the Applicants had stated that they had not quantified the annual reduction to personnel cost that could be achieved as a result of such employee separations. However, there would be no purpose to such separation costs, unless the anticipated savings from the employee separations were significantly greater than the costs. AG/CUB Ex. 4.0 at 6.

In addition, less than half of the forecasted savings in Docket No. 06-0540 were estimated to come from staffing reductions ($170.5 million out of total savings of $373.0 million in the first five years following the merger). Therefore, Mr. Effron rejected the notion that the commitment to maintain the number of Nicor Gas distribution full time equivalent employees at the current level means that there will be no synergies or cost savings opportunities in the period immediately following the merger. In fact, he stated that given the anticipated separation of administrative and management employees and the Applicants statements in their presentation materials regarding "achievable financial and operational benefits driven by increased scale and scope" and "savings through the elimination of duplicate public company costs," he believes that it is highly likely that completion of the merger will produce immediate savings from synergies and economies of scale. AG/CUB Ex. 3.0 at 6.

When the evidence is viewed as a whole, it is clear that there is a certain, troubling nonchalance in the Companies' attitude toward calculating savings that is inconsistent with the Commission's duty under Section 7-204(c) of the Act. The Commission is charged with allocating any savings resulting from the proposed reorganization, and cannot approve a reorganization without ruling on the savings issue. 220 ILCS 5/7-204(c). Moreover, when asked to provide an estimate of the long-term operational benefits that will inure to the benefit of Nicor Gas customers, *the JAs position is that review has not been performed.* Tr. at 595; AG Cross Ex. 19 (JA Response to AG 1.07). Mr. O'Connor, however, testified that "the Joint Applicants have evaluated and determined that there are not quantifiable savings related to Nicor Gas resulting from the proposed reorganization." JA Ex. 11.0 at 6. As Mr. Effron rightly notes, "It appears to be the Joint Applicants' position that because they have not presented any estimate of the savings from the reorganization, there will be no savings. This is a non-sequitur, and any claim of zero savings is not plausible." AG/CUB Ex. 4.0 at 7.

In sum, the stipulation entered into between Staff and JA in no way protects ratepayers. The JA have made clear that they do not expect, and indeed may not be looking for, merger savings at the regulated utility level. No tracking mechanism exists to monitor whether savings are, in fact, occurring. Accordingly, the stipulation's promise to allocate all savings to ratepayers in a future rate case is a hollow promise that in no way satisfies the statutory requirement of Section 7-204(c) of the Act.

~~The issue, then, is whether the Stipulation, if approved by the Commission would be sufficient to support the findings required by the two sub-parts of subsection 7-204(c). The resolution of that issue is found within the interplay between the pertinent statutory text and the first numbered paragraph above. Subpart (i) of the statute contemplates an "allocation of any savings." Both before and after the Stipulation was filed, the argument between the JA and AG/CUB focused on the implications of the word "any"~~

(that is, whether there will be savings, when they will occur, their quantification, and the degree to which they will arise from regulated business). In our view, the Stipulation moves the necessary analysis to the word "allocation," which we construe as a directive to determine the *beneficiaries* of savings and to *apportion* their respective shares. Under the first indented paragraph above, the *only* beneficiaries are NG's ratepayers. Thus, whether savings result or not, and whatever their magnitude, they must all flow to ratepayers to reduce NG's purported recoverable costs in a ratemaking proceeding. In statutory terms, that is the requisite allocation of any and all savings generated by the proposed Reorganization.

AG/CUB emphasize, however, that the Stipulation contains certain loopholes that the JA can exploit to ratepayers disadvantage. First, they stress that the three-year prohibition on base rate increases "is waived" if NG claims financial distress during that period[19]. Similarly, they note that the Stipulation permits NG to initiate a rate case as early as next year if it does not enter into a substitute natural gas sourcing agreement[20]. While these observations are correct, they do not affect the savings allocation specified in the first numbered paragraph. Whether NG's next rate case begins during the three-year interval after merger or sometime later, savings will still be allocated only to ratepayers.

The same principle applies to AG/CUB's additional concern that the Stipulation will not limit NG's choice of test year in its next rate proceeding. Although it is true that NG will therefore be free to "strategically select the most advantageous test year"[21] (in a manner consistent with test year rules), the allocation of all savings to ratepayers will not change. That said, the Commission does understand that AG/CUB's theory is that NG will endeavor to raise rates before savings are fully realized in its cost structure, so that it can over-earn later, when its actual costs shrink[22]. Putting that another way, AG/CUB claim that NG will pass *all* savings to ratepayers when *all* savings are still relatively small. But even if we assume, for the sake of argument, that NG would choose its test year to facilitate such a strategy, we do not assume our subsection 7-204(c)(i) authority (and duty) to *allocate* savings empowers us to override our test year regulations, which afford utilities specified test year "options."[23] The fact that one of those options is more "advantageous" does not preclude NG from selecting it[24].

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[19] AG/CUB RB at 17. In fact, the Stipulation grants NG only the right to *request* a waiver (although this distinction does not affect our analysis here).

[20] AG/CUB RB at 18.

[21] *Id*. at 18.

[22] AG/CUB define the "most advantageous test year" as "that which provides the utility with the highest revenue increase, and reflects the least amount of net savings for customers." *Id*.

[23] 83 Ill. Adm. Code 287.20.

[24] Moreover, as a practical matter, the available test year options under our rule (historic and future) would enable NG to withhold no more than 12 months of incremental savings from the ratemaking process - and even then, the utility would need to avoid the *pro forma* adjustments or updates required by Part 287 and Commission decisions. Further, all other cost elements (*e.g.*, prevailing cost of capital) would have to align with the strategy to make it worthwhile.

By the same token, the Commission cannot allow the JA-Staff Stipulation to contravene our test year rules either. The first and second numbered paragraphs of the Stipulation summary above describe the savings that will flow through to ratepayers as "achieved." While such savings should certainly flow through, so, too, should any additional savings that would otherwise be recognized under the test year rules in Part 287 or in prior Commission rulings. For illustration, if an historical test year were employed, and known and measurable savings were certain to occur in the pertinent future time frame, they could not be ignored, insofar as our test year rules would recognize them. Therefore, the first two numbered paragraphs above (numbered paragraphs three and four of the Stipulation as filed) must be revised in order to be approved as appropriate conditions for merger approval[25].

Additionally, there is a fundamental flaw in the first numbered paragraph above that would allow NG to flow *less than all* merger-related savings to ratepayers under certain circumstances. By its terms, the paragraph only applies to rate cases "filed by" NG. Consequently, in a rate proceeding filed *by the Commission*, NG's voluntary allocation of all merger-related savings to ratepayers would not apply. Subsection 7-204(c)(i) therefore compels the Commission to provide a savings allocation for any later ratemaking proceedings initiated by us. Consistent with our previous decisions in reorganization proceedings, on which the JA rely[26], the Commission holds that any and all merger-related savings shall be allocated to ratepayers in *any* future NG ratemaking proceeding conducted by the Commission. Therefore, the final eight words ("a future rate case filed by Nicor Gas") in numbered paragraph three in the August 24, 2011 Stipulation (which is identical to the first numbered paragraph above, except for an abbreviation) must be disapproved and replaced by the words "any future rate case involving Nicor Gas."[27]

With respect to costs incurred in accomplishing the Reorganization, the initial question framed by the statute is whether the merging companies should be allowed to recover such costs at all. In the fourth numbered paragraph above (which is identical to numbered paragraph six in the August 24, 2011 Stipulation) the JA agree that no such costs (as defined in that paragraph) can be recovered through Illinois jurisdictional regulated rates in any future proceeding. The Commission approves that agreement, which produces the same result (no reorganization cost recovery) as our previous decisions in reorganization proceedings.

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[25] Such revision appears in the Required Conditions of Approval attached as Appendix A to, and incorporated in, this Order.

[26] In Frontier Communications Corp., *et al.*, Dckt. 09-0268, the Commission concluded "that the allocation of any savings resulting from the proposed reorganization would flow through to the costs associated with regulated intrastate operations for consideration in setting rates by the Commission in any future rate request." Order, April 21, 2010, at 39. Similarly, in Illinois-American Water Co., Dckt. 01-0832, we held "under Section 7-204(c)(i) that, to the extent any synergy savings resulting from the proposed Reorganization are reflected in future rate case test years, such savings should be allocated in full to customers." Order, Nov. 20, 2002, at 18-19. Both of these quoted passages appear in JA RB at 21.

[27] This revision appears in the Required Conditions of Approval attached as Appendix A to, and incorporated in, this Order.

~~**2. Commission Conclusion**~~

~~The Commission concludes that subsection 7-204(c) of the Act shall be applied in the instant case by allocating all reorganization-related savings to ratepayers and precluding recovery by NG of any costs incurred in accomplishing the Reorganization (as defined above). Irrespective of when, how or by whom a future NG ratemaking proceeding is initiated, all savings must flow through to the costs associated with regulated operations under our jurisdiction.~~

C. Exception No. 3 -- The ALJPO's Conclusion that Nicor Services May Solicit NG Customers through Nicor Gas Billing Envelopes Should be Stricken from the Commission's Final Order.

As noted in the Introduction of this Brief, the ALJPO provides a careful and thorough analysis of the Operating Agreement issues in this docket, particularly with respect to its conclusions that 1) NG's provision of solicitation services on behalf of NS for GLCG provides an unlawful subsidy to the affiliate; 2) NS's solicitation privileges during inbound customer calls to NG have substantial anti-competitive impact in NG's service territory, which is adverse to the public interest; and 3) the GLCG solicitations performed during consumer calls to the utility are misleading and not in the public interest for NG to continue facilitating such solicitation. ALJPO at 54, 63, 67. Indeed, the ALJPO asserts:

> The Commission concludes that the GLCG solicitations performed during consumer calls to the utility are misleading with respect to the material fact that inspection and repair of customer-owned gas lines and brass connectors is available directly from NG on an as-needed basis. *It is not in the public interest for NG to continue facilitating such solicitation.*

ALJPO at 63 (emphasis added).

A later portion of the ALJPO GLCG analysis, however, raises concern.. In its correct dismissal of the JA complaint that precluding NG involvement in call center customer solicitation will eliminate opportunities to hear about NS affiliate products, the ALJPO states:

> That certainly does not mean, however, that NS cannot solicit customers via other channels (including NG bill inserts).

ALJPO at 69-70 (footnote omitted). In a footnote, the ALJPO notes, "We assume that NS inserts would not convey the false impression that repairs are unavailable from NG." *Id.* at 70. Given the ALJPO's statement that the Commission lacks the authority to monitor unregulated NS activity[28], it is unclear how and why that assumption is valid. It is unwise for the Order to invite the utility, given the Order's conclusions that it is not in the public interest for NG to continue facilitating the solicitation of GLCG, to accept written inserts for that same service, which may convey the same misleading impressions it concluded existed in current call center scripts.

As documented in the PO, the Commission can condition approval of the merger pursuant to Section 7-204, and take action as it relates to NG's activities that are necessary to safeguard "the public interest" within the meaning of Section 7-101 of the Act, and necessary to protect the interests of the utility and its customers, within the meaning of subsection 7-204(f) and subsection 7-204(A)(b). As the ALJPO notes, too, a condition can be deemed necessary for the public convenience, and one which the Commission deems proper, within the meaning of subsection 7-102(C) of the Act. ALJPO at 75. The ALJPO notes that NG itself suggests several alternatives ("door-to-door sales, print, television, radio, internet, telephonic and newsletters") as alternative means of solicitation of NG customers. While AG-CUB continue to view GLCG as a valueless service, these other means of solicitation by NS at least would not involve the use of NG resources to solicit captive NG customers. The same cannot be said for NG's billing envelopes. AG/CUB urges the Commission to prohibit NG from accepting this form of solicitation of GLCG (specifically) through NG bills as a condition of any merger approval.

[28] ALJPO at 55: "However, as NG underscores, neither NS nor its services have been placed under our statutory authority[28]. It follows that we cannot mandate changes to NS's sales scripts, service agreements or disclosures, including those involving GLCG."

Should the Commission reject the merger in its Final Order, the Commission should nevertheless modify the Operating Agreement proposed in ICC Docket No. 09-0301 in accordance with Staff's specific recommendation to prohibit NG affiliates from utilizing call center services for the solicitation of affiliate products, consistent with the conclusions in the Proposed Order in this docket, and in particular prohibit the use of any NG resources for the solicitation of GLCG.

Proposed Exceptions Language:

Accordingly, consistent with the argument presented above, AG/CUB urges the Commission to modify the following language at page 70 of the ALJPO as follows:

> In requiring the foregoing corrective action, the Commission dismisses NG's warning that we "eliminate entirely the opportunity for [NG's] customers to hear about affiliate products and services during any customer service phone call."[29] The opportunity to solicit business for affiliates *during utility customer service calls* is precisely what we intend to eliminate. That certainly does not mean, however, that NS cannot solicit customers via other channels. ~~(including NG bill inserts[30]).~~ NG itself suggests several alternatives ("door-to-door sales, print, television, radio, internet, telephonic and newsletters") that it regards as entirely satisfactory for NS's competitors[31]. Moreover, NS will continue to enjoy the benefit of the Nicor brand as it sells its products and services via such alternative channels. However, NG is hereby prohibited from using its regulated resources for solicitation of GLCG.

III. CONCLUSION

Wherefore, the People of the State of Illinois and the Citizens Utility Board respectfully request that the Commission enter an Order consistent with the recommendations made in this Brief on Exceptions.

Respectfully submitted,
THE PEOPLE OF THE

[29] NG IB-OA at 12.
[30] ~~NG Ex. 4.0 at 23. We assume that NS inserts would not convey the false impression that repairs are unavailable from NG.~~
[31] *Id*.

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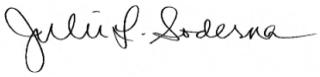

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